

Message Text

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SUBJECT: EDRC ANNUAL REVIEW ITALY

REF.: EDR(73)22

1. EDRC ANNUAL REVIEW OF ITALY SCHEDULED FOR NOVEMBER 21. REFDOC AND MAIN ISSUES PAPER AIRPOUCHED TO ROME AND WASHINGTON. SECRETARIAT'S MAIN POLICY CONCLUSIONS OUTLINED BELOW. UNLESS OTHERWISE INSTRUCTED, WE INTEND FOLLOW GENERAL LINES OF THESE CONCLUSIONS AT SUBJECT MEETING.

2. PRINCIPAL QUESTIONS FOR POLICY FORMULATION INVOLVED WHETHER SUPPLY FROM OUTDATED CAPITAL STOCK CAN RESPOND TO EXPECTED GROWTH OF DEMAND, AND WHETHER RISKS OF INFLATIONARY PRESSURE AND BALANCE OF PAYMENTS DISEQUILIBRIA CAN BE CONTAINED. (A). DOMESTIC DEMAND. WITH REGARD CAPACITY CONSTRAINTS, SECRETARIAT SEES ADEQUATE CAPACITY MARGINS IN INDUSTRY AT END OF 1973. THEY ASSUME POSSIBLE OIL CUTBACKS WILL NOT DISRUPT INDUSTRIAL PRODUCTION, AND THAT THERE WILL BE NO WIDESPREAD STRIKES. THEY FORESEE INCREASE IN REAL GNP FOR 1974 OF ABOUT 7 PERCENT AND EXPECT PRODUCTIVE

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INVESTMENT TO CONTINUE ITS PRESENT UPWARD TREND. (B) PRICES AND

COSTS: SECRETARIAT SEES INFLATIONARY OUTLOOK AS MATTER FOR SERIOUS CONCERN. EXTERNAL INFLUENCES LIKELY TO BE UNFAVORABLE AGAIN IN 1974 WITH ADDITIONAL IMPORT PRICE RISES FORESEEN. PROSPECT FOR MAJOR WAGE INCREASES APPEARS LESS SERIOUS SINCE MANY MAJOR CONTRACTS ALREADY SIGNED. (C) MONETARY POLICY. MAIN CONCLUSION IS THAT DEMAND RESTRAINT INAPPROPRIATE FOR ITALY WHERE INSUFFICIENT GROWTH OF DEMAND HAS BEEN PRINCIPAL FACTOR BEHIND SOCIAL UNREST AND WAGE EXPLOSIONS OF RECENT PAST. ECONOMY NEEDS TO BE STEERED CLOSE TO CAPACITY. SECRETARIAT FEARS THAT PRESENT CEILINGS ON CREDIT EXPANSION MAY DAMPEN NEEDED UPSWING OF INVESTMENT AND BELIEVE THEY SHOULD BE RELAXED. SECRETARIAT SEES USEFUL ROLE FOR PRICE CONTROLS IN PREVENTING INFLATIONARY EXPECTATIONS FROM ACCENTUATING PRICE WAGE SPIRAL. SELECTIVE TAX INCREASES WOULD BE PREFERABLE TO MONETARY RESTRICTIONS. (D) BUDGET POLICY: SECRETARIAT SEES PROSPECTS OF IMPROVED REVENUES FROM VALUE ADDED TAX AND FROM GENERAL REFORM OF DIRECT TAXATION IN 1974. (E) BALANCE OF PAYMENTS: SECRETARIAT CONCLUDES THAT CONTROLS ON CAPITAL MOVEMENTS IMPOSED IN JULY CONTRIBUTED TO RECOVERY OF EXCHANGE RATE AND SOMEWHAT REDUCED OUTFLOW OF CAPITAL. SECRETARIAT SEES HIGH INCREASE IN VOLUME OF IMPORTS IN RESPONSE TO STRENGTH OF DOMESTIC DEMAND, AND EXPECTS EXPORTS WILL BENEFIT FROM 1973 DEPRECIATION IN CURRENCY. MAIN QUESTION FOR EXPORTS MAY BE CAPACITY OF ITALIAN INDUSTRY TO SATISFY FOREIGN DEMAND. SECRETARIAT THINKS EXTERNAL SECTOR WILL CREATE NO IMPORTANT CONSTRAINT TO DOMESTIC EXPANSION IF OUTFLOW OF CAPITAL CAN BE CONTROLLED, AND EVEN SEES SHIFT FROM CURRENT ACCOUNT DEFICIT TO SURPLUS DURING 1974.

3. SINGLE RESERVED NO. 20 TO 22 INCLUSIVE FOR EDWARD SACCHET AT HOTEL MASSENET, 5 BIS RUE MASSENET, XVI. TEL: 288-5361.

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